

CVS CORP
Form 10-Q
August 09, 2005
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended

July 2, 2005

Commission File Number

001-01011

CVS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

05-0494040
(I.R.S. Employer Identification Number)

One CVS Drive, Woonsocket, Rhode Island 02895

(Address of principal executive offices)

Telephone: (401) 765-1500

Edgar Filing: CVS CORP - Form 10-Q

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ☒ No ☐

Common Stock, \$0.01 par value, issued and outstanding at August 3, 2005:

812,906,000 shares

Table of Contents

INDEX

	<u>Page</u>
Part I	
Item 1. Financial Statements	
<u>Consolidated Condensed Statements of Operations (Unaudited) - Thirteen and Twenty-Six Weeks Ended July 2, 2005 and July 3, 2004</u>	2
<u>Consolidated Condensed Balance Sheets (Unaudited) - As of July 2, 2005 and January 1, 2005</u>	3
<u>Consolidated Condensed Statements of Cash Flows (Unaudited) - Twenty-Six Weeks Ended July 2, 2005 and July 3, 2004</u>	4
<u>Notes to Consolidated Condensed Financial Statements</u>	5
<u>Report of Independent Registered Public Accounting Firm</u>	11
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	20
Item 4. <u>Controls and Procedures</u>	20
Part II	
Item 1. <u>Legal Proceedings</u>	21
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	22
Item 5. <u>Other Information</u>	23
Item 6. <u>Exhibits</u>	24
<u>Signature Page</u>	24

Table of Contents**Part I****Item 1****CVS Corporation****Consolidated Condensed Statements of Operations****(Unaudited)**

	<i>13 Weeks Ended</i>		<i>26 Weeks Ended</i>	
	<i>July 2,</i>	<i>July 3,</i>	<i>July 2,</i>	<i>July 3,</i>
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
<i>In millions, except per share amounts</i>				
Net sales	\$ 9,121.6	\$ 6,943.1	\$ 18,303.8	\$ 13,761.7
Cost of goods sold, buying and warehousing costs	6,704.2	5,116.6	13,505.6	10,163.5
Gross margin	2,417.4	1,826.5	4,798.2	3,598.2
Selling, general and administrative expenses	1,792.1	1,343.2	3,535.2	2,615.9
Depreciation and amortization	147.6	96.1	285.5	189.5
Total operating expenses	1,939.7	1,439.3	3,820.7	2,805.4
Operating profit	477.7	387.2	977.5	792.8
Interest expense, net	28.3	6.0	56.3	13.8
Earnings before income tax provision	449.4	381.2	921.2	779.0
Income tax provision	173.5	146.7	355.6	299.9
Net earnings	275.9	234.5	565.6	479.1
Preference dividends, net of income tax benefit	3.5	3.7	7.0	7.3
Net earnings available to common shareholders	\$ 272.4	\$ 230.8	\$ 558.6	\$ 471.8
Basic earnings per common share:				
Net earnings	\$ 0.34	\$ 0.29	\$ 0.69	\$ 0.59
Weighted average basic common shares outstanding	810.9	796.0	808.8	794.4
Diluted earnings per common share:				
Net earnings	\$ 0.33	\$ 0.28	\$ 0.67	\$ 0.58
Weighted average diluted common shares outstanding	841.9	830.0	839.6	827.2
Dividends declared per common share	\$ 0.03625	\$ 0.03313	\$ 0.07250	\$ 0.06625

See accompanying notes to consolidated condensed financial statements.

Table of Contents**Part I****Item 1****CVS Corporation****Consolidated Condensed Balance Sheets****(Unaudited)**

	July 2, 2005	January 1, 2005
<i>In millions, except share and per share amounts</i>		
Assets:		
Cash and cash equivalents	\$ 414.1	\$ 392.3
Accounts receivable, net	1,703.8	1,764.2
Inventories	5,360.4	5,453.9
Deferred income taxes	223.1	243.1
Other current assets	92.9	66.0
Total current assets	7,794.3	7,919.5
Property and equipment, net	3,972.2	3,505.9
Goodwill	1,828.5	1,898.5
Intangible assets, net	822.3	867.9
Deferred income taxes	132.1	137.6
Other assets	216.4	217.4
Total assets	\$ 14,765.8	\$ 14,546.8
Liabilities:		
Accounts payable	\$ 2,054.8	\$ 2,275.9
Accrued expenses	1,424.0	1,666.7
Short-term debt	875.0	885.6
Current portion of long-term debt	338.1	30.6
Total current liabilities	4,691.9	4,858.8
Long-term debt	1,629.7	1,925.9
Other long-term liabilities	761.7	774.9
Shareholders' equity:		
Preference stock, series one ESOP convertible, par value \$1.00: authorized 50,000,000 shares; issued and outstanding 4,224,000 shares at July 2, 2005 and 4,273,000 shares at January 1, 2005	225.7	228.4
Common stock, par value \$0.01: authorized 1,000,000,000 shares; issued 837,220,000 shares at July 2, 2005 and 828,552,000 shares at January 1, 2005	8.4	8.3
Treasury stock, at cost: 25,680,000 shares at July 2, 2005 and 26,634,000 shares at January 1, 2005	(373.0)	(385.9)
Guaranteed ESOP obligation	(140.9)	(140.9)
Capital surplus	1,863.8	1,687.3
Retained earnings	6,152.6	5,645.5
Accumulated other comprehensive loss	(54.1)	(55.5)
Total shareholders' equity	7,682.5	6,987.2
Total liabilities and shareholders' equity	\$ 14,765.8	\$ 14,546.8



See accompanying notes to consolidated condensed financial statements.

Table of Contents**Part I****Item 1****CVS Corporation****Consolidated Condensed Statements of Cash Flows****(Unaudited)**

<i>In millions</i>	<i>26 Weeks Ended</i>	
	<i>July 2,</i>	<i>July 3,</i>
	<i>2005</i>	<i>2004</i>
Cash flows from operating activities:		
Cash receipts from sales	\$ 18,361.8	\$ 13,894.9
Cash paid for inventory	(13,314.0)	(10,163.6)
Cash paid to other suppliers and employees	(4,083.8)	(2,813.8)
Interest received	3.2	3.6
Interest paid	(65.8)	(27.5)
Income taxes paid	(300.3)	(334.4)
Net cash provided by operating activities	601.1	559.2
Cash flows from investing activities:		
Additions to property and equipment	(731.7)	(464.4)
Proceeds from sale-leaseback transactions	7.3	4.7
Acquisitions (net of cash acquired) and investments	63.7	(40.8)
Proceeds from sale or disposal of assets	8.7	8.5
Net cash used in investing activities	(652.0)	(492.0)
Cash flows from financing activities:		
Reductions in short-term debt	(10.6)	
Dividends paid	(58.5)	(52.5)
Additions to long-term debt	16.5	
Reductions in long-term debt	(5.3)	(300.4)
Proceeds from exercise of stock options	130.6	65.4
Net cash provided by (used in) financing activities	72.7	(287.5)
Net increase (decrease) in cash and cash equivalents	21.8	(220.3)
Cash and cash equivalents at beginning of period	392.3	843.2
Cash and cash equivalents at end of period	\$ 414.1	\$ 622.9
Reconciliation of net earnings to net cash provided by operating activities:		
Net earnings	\$ 565.6	\$ 479.1
Adjustments required to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	285.5	189.5
Deferred income taxes and other noncash items	42.3	(16.1)

Edgar Filing: CVS CORP - Form 10-Q

Change in operating assets and liabilities, providing/(requiring) cash, net of effects from acquisitions:

Accounts receivable, net	57.9	133.3
Inventories	94.1	13.1
Other current assets	(27.0)	(24.0)
Other assets	5.1	8.9
Accounts payable	(223.9)	(10.0)
Accrued expenses	(170.2)	(208.7)
Other long-term liabilities	(28.3)	(5.9)
	<hr/>	<hr/>
Net cash provided by operating activities	601.1	559.2
	<hr/>	<hr/>

See accompanying notes to consolidated condensed financial statements.

Table of Contents**Part I****Item 1****CVS Corporation****Notes to Consolidated Condensed Financial Statements****(Unaudited)****Note 1**

The accompanying consolidated condensed financial statements of CVS Corporation and its wholly-owned subsidiaries (*CVS* or the *Company*) have been prepared without audit, in accordance with the rules and regulations of the Securities and Exchange Commission. In accordance with such rules and regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Company believes that the disclosures included herein are adequate to make the information presented not misleading. These consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Exhibit 13 to the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2005.

In the opinion of management, the accompanying consolidated condensed financial statements include all adjustments (consisting only of normal recurring adjustments), which are necessary to present a fair statement of the Company's results for the interim periods presented. Because of the influence of various factors on the Company's operations, including certain holidays and other seasonal influences, net earnings for any interim period may not be comparable to the same interim period in previous years or necessarily indicative of earnings for the full fiscal year.

Note 2

The Company accounts for its stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board (*APB*) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. As such, no stock-based employee compensation cost is reflected in net earnings for options granted under those plans since they had an exercise price equal to the market value of the underlying common stock and the number of shares were fixed on the date of grant. The following table summarizes the effect on net earnings and earnings per common share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards (*SFAS*) No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation for the respective periods:

	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	<i>July 2,</i>	<i>July 3,</i>	<i>July 2,</i>	<i>July 3,</i>
<i>In millions, except per share amounts</i>	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
Net earnings, as reported	\$ 275.9	\$ 234.5	\$ 565.6	\$ 479.1
Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effects ⁽¹⁾	0.7	0.5	1.6	0.9

Edgar Filing: CVS CORP - Form 10-Q

Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	11.4	10.0	22.8	21.2
	<hr/>	<hr/>	<hr/>	<hr/>
Pro forma net earnings	\$ 265.2	\$ 225.0	\$ 544.4	\$ 458.8
	<hr/>	<hr/>	<hr/>	<hr/>
Basic EPS:				
As reported	\$ 0.34	\$ 0.29	\$ 0.69	\$ 0.59
Pro forma	0.32	0.28	0.66	0.57
	<hr/>	<hr/>	<hr/>	<hr/>
Diluted EPS:				
As reported	\$ 0.33	\$ 0.28	\$ 0.67	\$ 0.58
Pro forma	0.31	0.27	0.65	0.55
	<hr/>	<hr/>	<hr/>	<hr/>

(1) Amounts represent the after-tax compensation costs for restricted stock grants.

Table of Contents**Part I****Item 1****CVS Corporation****Notes to Consolidated Condensed Financial Statements****(Unaudited)****Note 3**

On July 31, 2004, the Company acquired certain assets and assumed certain liabilities from J.C. Penney Company, Inc. and certain of its subsidiaries, including Eckerd Corporation (Eckerd). The acquisition included 1,268 Eckerd retail drugstores and Eckerd Health Services, which includes Eckerd's mail order and pharmacy benefit management businesses (collectively, the Acquired Businesses). The final purchase price was \$2.13 billion. The Company anticipates that the valuation of the assets acquired and liabilities assumed will be finalized during the third quarter of 2005.

The following pro forma combined results of operations have been provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined companies for the periods presented, or that will be achieved by the combined company in the future:

<i>In millions, except per share amounts</i>	<i>July 3, 2004</i>	
	<i>13 weeks</i>	<i>26 weeks</i>
Pro forma: ⁽¹⁾⁽²⁾		
Net sales	\$ 8,588.1	\$ 17,192.7
Net earnings	209.5	456.8
Basic earnings per share	\$ 0.26	\$ 0.57
Diluted earnings per share	0.25	0.56

- (1) The pro forma combined results of operations assume that the acquisition of the Acquired Businesses occurred at the beginning of each period presented. Such results have been prepared by adjusting the historical results of the Company to include the historical results of the Acquired Businesses, the incremental interest expense and the impact of the preliminary purchase price allocation.
- (2) The pro forma combined results of operations do not include any cost savings that may result from the combination of the Company and the Acquired Businesses or any costs that will be incurred by the Company to integrate the Acquired Businesses.

Note 4

On May 12, 2005, CVS Corporation's Board of Directors authorized a two-for-one common stock split, which was effected in the form of a dividend by the issuance of one additional share of common stock for each share of common stock outstanding. These shares were distributed on June 6, 2005 to shareholders of record as of May 23, 2005. The accompanying consolidated condensed financial statements have been restated to

reflect the effect of the two-for-one common stock split.

Note 5

The Company accounts for goodwill and intangibles under SFAS No. 142, Goodwill and Other Intangible Assets. As such, goodwill and other indefinite-lived intangible assets are not amortized, but are subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate there may be an impairment. During the third quarter of 2004, the Company performed its required annual goodwill impairment test. That annual review concluded there was no impairment of goodwill.

Table of Contents**Part I****Item 1****CVS Corporation****Notes to Consolidated Condensed Financial Statements****(Unaudited)**

The carrying amount of goodwill was \$1,828.5 million as of July 2, 2005. The decrease in the carrying amount of goodwill during the twenty-six weeks ended July 2, 2005 was primarily due to a favorable adjustment to the purchase price paid for the Acquired Businesses. There has been no impairment of goodwill during the twenty-six weeks ended July 2, 2005.

Intangible assets other than goodwill are required to be separated into two categories: finite-lived and indefinite-lived. Intangible assets with finite useful lives are amortized over their estimated useful life, while intangible assets with indefinite useful lives are not amortized. The Company currently has no intangible assets with indefinite lives.

Following is a summary of the Company's amortizable intangible assets as of the respective balance sheet dates:

<i>In millions</i>	<i>As of July 2, 2005</i>		<i>As of January 1, 2005</i>	
	Gross		Gross	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Customer lists and Covenants not to compete	\$ 1,118.1	\$ (378.5)	\$ 1,102.8	\$ (321.8)
Favorable leases and Other	176.0	(93.3)	173.8	(86.9)
	\$ 1,294.1	\$ (471.8)	\$ 1,276.6	\$ (408.7)

The increase in the gross carrying amount of customer lists and covenants not to compete during the twenty-six weeks ended July 2, 2005 was primarily due to the acquisition of customer lists. The amortization expense for these finite-lived intangible assets for the thirteen and twenty-six week periods ended July 2, 2005 was \$32.0 million and \$64.0 million, respectively. The anticipated annual amortization expense for these intangible assets is \$127.1 million, \$121.4 million, \$115.6 million, \$106.7 million, \$98.0 million and \$88.7 million in 2005, 2006, 2007, 2008, 2009 and 2010, respectively.

Note 6

As of July 2, 2005, the Company operated 5,439 retail and specialty pharmacy stores in 36 states and the District of Columbia. The Company currently operates two business segments, Retail Pharmacy and Pharmacy Benefit Management (PBM). The Company's business segments are operating units that offer different products and services, and require distinct technology and marketing strategies.

Edgar Filing: CVS CORP - Form 10-Q

As of July 2, 2005, the Retail Pharmacy segment included 5,390 retail drugstores and the Company's online retail website, CVS.com®. The retail drugstores, which operate under the CVS® or CVS/pharmacy® name, are located in 34 states and the District of Columbia.

The PBM segment, which operates under the PharmaCare Management Services name, provides a full range of prescription benefit management services to managed care and other organizations. These services include plan design and administration, formulary management, mail order pharmacy services, claims processing and generic substitution. The PBM segment also includes the Company's specialty pharmacy business, which operates under the PharmaCare Pharmacy® name and focuses on supporting individuals that require complex and expensive drug therapies. The PBM segment operates 49 retail and specialty pharmacies, located in 19 states and the District of Columbia.

Table of Contents**Part I****Item 1****CVS Corporation****Notes to Consolidated Condensed Financial Statements****(Unaudited)**

Following is a reconciliation of the Company's business segments to the consolidated condensed financial statements as of and for the respective periods:

<i>In millions</i>	Retail Pharmacy	PBM	Consolidated
	Segment	Segment	Totals
<i>13 weeks ended:</i>			
July 2, 2005:			
Net sales	\$ 8,431.7	\$ 689.9	\$ 9,121.6
Operating profit	422.0	55.7	477.7
<i>July 3, 2004:</i>			
Net sales	\$ 6,619.6	\$ 323.5	\$ 6,943.1
Operating profit	362.9	24.3	387.2
<i>26 weeks ended:</i>			
July 2, 2005:			
Net sales	\$ 16,921.4	\$ 1,382.4	\$ 18,303.8
Operating profit	870.0	107.5	977.5
<i>July 3, 2004:</i>			
Net sales	\$ 13,099.5	\$ 662.2	\$ 13,761.7
Operating profit	743.4	49.4	792.8
Total assets:			
July 2, 2005	\$ 13,396.5	\$ 1,369.3	\$ 14,765.8
January 1, 2005	13,118.5	1,428.3	14,546.8

Note 7

Accumulated other comprehensive loss consists of a minimum pension liability and market value adjustments on hedge instruments. The minimum pension liability totaled \$57.7 million pre-tax (\$35.7 million after-tax) as of July 2, 2005 and January 1, 2005. The unrealized loss on derivatives totaled \$29.0 million pre-tax (\$18.4 million after-tax) and \$31.2 million pre-tax (\$19.8 million after-tax) as of July 2, 2005 and January 1, 2005, respectively. As of July 2, 2005, the Company had no freestanding derivatives in place.

Following are the changes in comprehensive income:

Edgar Filing: CVS CORP - Form 10-Q

	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
<i>In millions</i>				
Net earnings, as reported	\$ 275.9	\$ 234.5	\$ 565.6	\$ 479.1
Other comprehensive loss:				
Recognition of unrealized loss on derivatives	0.7	(10.5)	1.4	(10.5)
Total comprehensive income, net of taxes	\$ 276.6	\$ 224.0	\$ 567.0	\$ 468.6

Table of Contents**Part I****Item 1****CVS Corporation****Notes to Consolidated Condensed Financial Statements****(Unaudited)****Note 8**

Following are the components of net interest expense:

<i>In millions</i>	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Interest expense	\$ 29.8	\$ 7.6	\$ 59.4	\$ 17.4
Interest income	(1.5)	(1.6)	(3.1)	(3.6)
Interest expense, net	\$ 28.3	\$ 6.0	\$ 56.3	\$ 13.8

Note 9

The Company previously disclosed in its consolidated financial statements for the fiscal year ended January 1, 2005 that it expected to make \$17.1 million in cash contributions to the defined benefit pension plans during fiscal 2005. During the twenty six-weeks ended July 2, 2005, the Company made cash contributions of \$1.4 million and expects to make additional cash contributions during the remainder of fiscal 2005.

Following is a summary of the net periodic pension costs for the defined benefit and other postretirement benefit plans for the respective periods.

<i>In millions</i>	<i>Defined Benefit Plans</i>			
	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Service cost	\$ 0.2	\$ 0.2	\$ 0.4	\$ 0.4

Edgar Filing: CVS CORP - Form 10-Q

Interest cost on benefit obligation	5.5	5.1	10.7	10.3
Expected return on plan assets	(4.8)	(4.6)	(9.7)	(9.3)
Amortization of net loss	1.9	0.8	3.3	1.7
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net periodic pension cost	\$ 2.8	\$ 1.5	\$ 4.7	\$ 3.1
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Other Postretirement Benefits

	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
<i>In millions</i>				
Interest cost on benefit obligation	0.2	0.2	0.4	0.4
Settlement gain	(0.1)	(0.1)	(0.2)	(0.2)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net periodic pension cost	\$ 0.1	\$ 0.1	\$ 0.2	\$ 0.2
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Table of Contents**Part I****Item 1****CVS Corporation****Notes to Consolidated Condensed Financial Statements****(Unaudited)****Note 10**

Basic earnings per common share is computed by dividing: (i) net earnings, after deducting the after-tax dividends on the ESOP preference stock, by (ii) the weighted average number of common shares outstanding during the period (the Basic Shares).

When computing diluted earnings per common share, the Company assumes that the ESOP preference stock is converted into common stock and all dilutive stock options are exercised. After the assumed ESOP preference stock conversion, the ESOP Trust would hold common stock rather than ESOP preference stock and would receive common stock dividends (\$0.1450 and \$0.1325 annually per share in 2005 and 2004, respectively) rather than ESOP preference stock dividends (currently \$3.90 annually per share). Since the ESOP Trust uses the dividends it receives to service its debt, the Company would have to increase its contribution to the ESOP Trust to compensate it for the lower dividends. This additional contribution would reduce the Company's net earnings, which in turn, would reduce the amounts that would have to be accrued under the Company's incentive compensation plans.

Diluted earnings per common share is computed by dividing: (i) net earnings, after accounting for the difference between the dividends on the ESOP preference stock and common stock and after making adjustments for the incentive compensation plans by (ii) Basic Shares plus the additional shares that would be issued assuming that all dilutive stock options are exercised and the ESOP preference stock is converted into common stock. Options to purchase 6.9 million and 12.3 million shares of common stock were outstanding as of July 2, 2005 and July 3, 2004, respectively, but were not included in the calculation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares and, therefore, the effect would have been antidilutive.

Following is a reconciliation of basic and diluted earnings per common share for the respective periods:

	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
<i>In millions, except per share amounts</i>				
Numerator for earnings per common share calculation:				
Net earnings	\$ 275.9	\$ 234.5	\$ 565.6	\$ 479.1
Preference dividends, net of income tax benefit	(3.5)	(3.7)	(7.0)	(7.3)
Net earnings available to common shareholders, basic	\$ 272.4	\$ 230.8	\$ 558.6	\$ 471.8
Net earnings	\$ 275.9	\$ 234.5	\$ 565.6	\$ 479.1

Edgar Filing: CVS CORP - Form 10-Q

Dilutive earnings adjustments	(1.0)	(1.3)	(2.1)	(2.7)
Net earnings available to common shareholders, diluted	<u>\$ 274.9</u>	<u>\$ 233.2</u>	<u>\$ 563.5</u>	<u>\$ 476.4</u>
Denominator for earnings per common share calculation:				
Weighted average common shares, basic	810.9	796.0	808.8	794.4
Effect of dilutive securities:				
Restricted stock units	0.2		0.2	
ESOP preference stock	19.6	20.4	19.7	20.4
Stock options	11.2	13.6	10.9	12.4
Weighted average common shares, diluted	<u>841.9</u>	<u>830.0</u>	<u>839.6</u>	<u>827.2</u>
Basic earnings per common share	<u>\$ 0.34</u>	<u>\$ 0.29</u>	<u>\$ 0.69</u>	<u>\$ 0.59</u>
Diluted earnings per common share	<u>\$ 0.33</u>	<u>\$ 0.28</u>	<u>\$ 0.67</u>	<u>\$ 0.58</u>

Table of Contents

Part I

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

CVS Corporation:

We have reviewed the consolidated condensed balance sheet of CVS Corporation and subsidiaries as of July 2, 2005, and the related consolidated condensed statements of operations and cash flows for the thirteen and twenty-six week periods ended July 2, 2005 and July 3, 2004. These consolidated condensed financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated condensed financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of CVS Corporation and subsidiaries as of January 1, 2005 and the related consolidated statements of operations, shareholders' equity, and cash flows for the fifty-two week period then ended (not presented herein); and in our report dated March 8, 2005 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of January 1, 2005, is fairly presented, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

KPMG LLP

Providence, Rhode Island
August 5, 2005

Table of Contents**Part I****Item 2****Management's Discussion and Analysis of Financial Condition and Results of Operations****Introduction**

Our company is the largest retail pharmacy in the United States based on store count. We sell prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, beauty products and cosmetics, film and photo finishing services, seasonal merchandise, greeting cards and convenience foods through our CVS/pharmacy® retail stores and online through CVS.com®. We also provide pharmacy benefit management, mail order and specialty pharmacy services through PharmaCare Management Services and PharmaCare Pharmacy® stores. As of July 2, 2005, we operated 5,439 retail and specialty pharmacy stores in 36 states and the District of Columbia.

The retail drugstore business is highly competitive. We believe that we compete principally on the basis of: (i) store location and convenience, (ii) customer service and satisfaction, (iii) product selection and variety and (iv) price. In each of the markets we serve, we compete with independent and other retail drugstore chains, supermarkets, convenience stores, pharmacy benefit managers, mail order prescription providers, discount merchandisers, membership clubs and Internet pharmacies.

On July 31, 2004, the Company acquired certain assets and assumed certain liabilities from J.C. Penney Company, Inc. and certain of its subsidiaries, including Eckerd Corporation (Eckerd). The acquisition included 1,268 Eckerd retail drugstores and Eckerd Health Services, which includes Eckerd's mail order and pharmacy benefit management businesses (collectively, the Acquired Businesses). The Company believes that the acquisition of the Acquired Businesses is consistent with its long-term strategy of expanding its retail drugstore business in high-growth markets and increasing the size and product offerings of its pharmacy benefits management business.

The following discussion explains the material changes in our results of operations for the thirteen and twenty-six weeks ended July 2, 2005 and July 3, 2004 and the significant developments affecting our financial condition since January 1, 2005. We strongly recommend that you read our audited consolidated financial statements and footnotes and Management's Discussion and Analysis of Financial Condition and Results of Operation included as Exhibit 13 to our Annual Report on Form 10-K for the fiscal year ended January 1, 2005.

Results of Operations**Thirteen and Twenty-Six Weeks Ended July 2, 2005 versus July 3, 2004**

Net sales ~ The following table summarizes our sales performance for the respective periods:

13 weeks ended

26 weeks ended

Edgar Filing: CVS CORP - Form 10-Q

	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Net sales (<i>in billions</i>)	\$ 9.1	\$ 6.9	\$ 18.3	\$ 13.8
Net sales increase:				
Total	31.4%	7.7%	33.0%	7.9%
Pharmacy	34.6%	8.0%	35.6%	8.7%
Front Store	24.1%	7.1%	26.9%	6.0%
Same store sales increase:				
Total	5.6%	6.1%	6.9%	6.2%
Pharmacy	7.4%	7.0%	8.1%	7.6%
Front Store	1.7%	4.1%	4.2%	3.1%
Pharmacy percentage of total sales	70.6%	69.1%	70.8%	69.7%
Third party percentage of pharmacy sales	93.9%	93.7%	94.0%	93.8%

Table of Contents

Part I

Item 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

As you review our sales performance, we believe you should consider the following important information:

Our increase in total sales was significantly affected by the July 31, 2004 acquisition of the Acquired Businesses. Excluding the sales from the Acquired Businesses, total sales increased approximately 7.9% and 9.1% during the second quarter and first six months of 2005, respectively. The acquired stores will be included in same-stores sales beginning with the fiscal August 2005 reporting period.

Our increase in total sales was also affected by new store openings. New store openings accounted for approximately 180 basis points and 170 basis points of the increase in total sales for the second quarter and the first six months of 2005, respectively.

Total sales continued to benefit from our active relocation program, which focuses on moving our existing shopping center stores to larger, more convenient, freestanding locations. Historically, we have achieved significant improvements in customer count and net sales when we do this. Although the number of annual relocations has decreased, our relocation strategy remains an important component of our overall growth strategy. As of July 2, 2005, approximately 58% of our existing stores were freestanding.

Our pharmacy sales growth continued to benefit from new market expansions, increased penetration in existing markets, our ability to attract and retain managed care customers and favorable industry trends. These trends include an aging American population; many baby boomers are now in their fifties and are consuming a greater number of prescription drugs. The increased use of pharmaceuticals as the first line of defense for healthcare also contributed to the growing demand for pharmacy services.

Pharmacy sales dollars continue to be negatively impacted by the conversion of brand named drugs to equivalent generic drugs, which typically have a lower selling price. In addition, our pharmacy growth has continued to be adversely affected by the growth of the mail order channel, an absence of significant new drug introductions, the effect of higher consumer co-payments and co-insurance on utilization trends and an increase in the number of over-the-counter remedies, which had historically only been available by prescription.

Front store sales for the thirteen weeks ended July 2, 2005 were negatively impacted by an earlier Easter (March 27th this year versus April 11th last year), which shifted more holiday sales into the first quarter. Excluding the impact of the Easter shift, we estimate total same store sales for the second quarter of 2005 would have been approximately 80 basis points higher, while front store same store sales would have been approximately 130 basis points higher. The Easter shift had no impact on the first six months of 2005.

Gross margin, which includes net sales less the cost of merchandise sold during the reporting period and the related purchasing costs, warehousing costs, delivery costs and actual and estimated inventory losses, increased \$590.9 million (or 32.4%) to \$2.4 billion, or 26.5% of net sales for the second quarter of 2005, compared to \$1.8 billion or 26.3% of net sales in the second quarter of 2004. Gross margin for the first six months of 2005 increased \$1.2 billion (or 33.4%) to \$4.8 billion, or 26.2% of net sales, compared to \$3.6 billion, or 26.2% of net sales in the first six months of 2004.

As you review our performance in this area, we believe you should consider the following important information:

Edgar Filing: CVS CORP - Form 10-Q

Our gross margin rate continues to benefit from the increase in generic drug sales (discussed above), which normally yield a higher gross margin rate than brand name drug sales. In addition, our gross margin rate continued to benefit from reduced inventory losses as a result of various new and continuing programs. While we believe these programs should continue to provide operational benefits, we expect the future financial improvement to be less significant. In addition, we cannot guarantee that our programs will continue to reduce inventory losses.

Table of Contents**Part I****Item 2****Management's Discussion and Analysis of Financial Condition and Results of Operations**

Pharmacy sales are growing at a faster pace than front store sales. On average, our gross margin on pharmacy sales is lower than our gross margin on front store sales. Pharmacy sales as a percentage of total sales for the second quarter and first six months of 2005 were 70.6% and 70.8%, respectively, compared to 69.1% in the second quarter of 2004 and 69.7% in the first six months of 2004.

Sales to customers covered by third party insurance programs have continued to increase and, thus, have become a larger part of our total pharmacy business. On average, our gross margin on third party pharmacy sales is lower than our gross margin on cash pharmacy sales. Third party prescription sales for the second quarter and first six months of 2005 were 93.9% and 94.0%, respectively, of pharmacy sales, versus 93.7% in the second quarter of 2004 and 93.8% in the first six months of 2004.

Total operating expenses, which include store and administrative payroll, employee benefits, store and administrative occupancy costs, selling expenses, advertising expenses, administrative expenses and depreciation and amortization expense, increased \$500.4 million (or 34.8%) to \$1,939.7 million, or 21.3% of net sales for the second quarter of 2005, compared to \$1,439.3 million, or 20.7% of net sales in the second quarter of 2004. Total operating expenses for the first six months of 2005 increased \$1,015.3 million (or 36.2%) to \$3,820.7 million or 20.9% of net sales, compared to \$2,805.4 million or 20.4% of net sales in the first six months of 2004. Total operating expenses as a percentage of net sales increased during the second quarter and first six months of fiscal 2005, primarily as a result of the Acquired Businesses having lower average sales per store. Further, the acquired stores have incurred higher labor costs resulting from the integration of the acquired stores. In addition, operating expenses as a percentage of net sales has been impacted by lower pharmacy sales growth, in part, from higher generic drug sales, which typically have a lower selling price than their brand named equivalents.

Interest expense, net consisted of the following:

<i>In millions</i>	<i>13 weeks ended</i>		<i>26 weeks ended</i>	
	<i>July 2, 2005</i>	<i>July 3, 2004</i>	<i>July 2, 2005</i>	<i>July 3, 2004</i>
Interest expense	\$ 29.8	\$ 7.6	\$ 59.4	\$ 17.4
Interest income	(1.5)	(1.6)	(3.1)	(3.6)
Interest expense, net	\$ 28.3	\$ 6.0	\$ 56.3	\$ 13.8

The increase in interest expense for the second quarter and first six months of 2005 was driven by the increase in debt used to fund the acquisition of the Acquired Businesses, which occurred during the third quarter of 2004.

Income tax provision ~ Our effective income tax rate was 38.6% for the second quarter and first six months of 2005, compared to 38.5% for the respective periods of 2004. The increase in our effective income tax rate was primarily due to higher state income taxes.

Edgar Filing: CVS CORP - Form 10-Q

Net earnings for the second quarter of 2005 increased \$41.4 million (or 17.6%) to \$275.9 million, or \$0.33 per diluted share, compared to \$234.5 million, or \$0.28 per diluted share, in the second quarter of 2004. Net earnings for the first six months of 2005 increased \$86.5 million (or 18.0%) to \$565.6 million, or \$0.67 per diluted share, compared to \$479.1 million, or \$0.58 per diluted share, in the first six months of 2004.

Table of Contents

Part I

Item 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Capital Resources

We anticipate that cash flows from operations, supplemented by commercial paper and long-term borrowings, will continue to fund the growth of our business.

Net cash provided by operating activities increased \$41.9 million to \$601.1 million during the first six months of 2005. This compares to net cash provided by operations of \$559.2 million during the first six months of 2004. The increase in net cash provided by operations during the first six months of 2005 primarily resulted from an increase in net income.

Net cash used in investing activities increased to \$652.0 million during the first six months of 2005. This compares to \$492.0 million used during the first six months of 2004. The increase in net cash used in investing activities was primarily due to higher additions to property and equipment. Additions to property and equipment totaled \$731.7 million in the first six months of 2005, compared to \$464.4 million in the first six months of 2004. The majority of the spending in both periods supported our real estate development program as well as the remodel program associated with the integration of the acquired stores.

During the first six months of 2005, we opened 103 new stores, relocated 75 stores and closed 39 stores. For the remainder of 2005, we plan to open 120-125 new or relocated stores. As of July 2, 2005, we operated 5,439 retail and specialty pharmacy stores in 36 states and the District of Columbia.

Net cash provided by financing activities increased to \$72.7 million during the first six months of 2005. This compares to \$287.5 million net cash used in financing activities during the first six months of 2004. The increase in net cash provided by financing activities was primarily due to proceeds from stock option exercises.

We had \$875.0 million of commercial paper outstanding at a weighted average interest rate of 2.8% as of July 2, 2005. In connection with our commercial paper program, we maintain a \$650 million, five-year unsecured back-up credit facility, which expires on May 21, 2006. During the second quarter of 2005, we replaced a \$675 million, 364-day unsecured back-up credit facility, which expired on June 10, 2005, with a \$675 million five-year unsecured back-up credit facility, which expires on June 2, 2010. In addition, we maintain a \$675 million five-year unsecured back-up credit facility, which expires on June 11, 2009. The credit facilities allow for borrowings at various rates depending on our public debt rating. As of July 2, 2005, we had no outstanding borrowings against the credit facilities.

Our credit facilities and unsecured senior notes contain customary restrictive financial covenants. These covenants do not include a requirement for the acceleration of our debt maturities in the event of a downgrade in our credit rating. We do not believe that the restrictions contained in these covenants materially affect our financial or operating flexibility.

Edgar Filing: CVS CORP - Form 10-Q

Our liquidity is based, in part, on maintaining investment-grade debt ratings. As of July 2, 2005, our long-term debt was rated A3 by Moody's and A- by Standard & Poor's, and our commercial paper program was rated P-2 by Moody's and A-2 by Standard & Poor's, each on a stable outlook. In assessing our credit strength, both Moody's and Standard & Poor's consider, among other things, our capital structure and financial policies as well as our consolidated balance sheet and other financial information. Our debt ratings have a direct impact on our future borrowing costs, access to capital markets and new store operating lease costs.

We believe that our cash on hand and cash provided by operations, together with our ability to obtain additional short-term and long-term financing, will be sufficient to cover our working capital needs, capital expenditures and debt service requirements for at least the next twelve months and the foreseeable future.

Table of Contents**Part I****Item 2****Management's Discussion and Analysis of Financial Condition and Results of Operations****Off-Balance Sheet Arrangements**

Other than in connection with executing operating leases, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, including variable interest entities, nor do we have or guarantee any off-balance sheet debt. We finance a portion of our new store development through sale-leaseback transactions, which involve selling stores to unrelated parties at net book value and then leasing the stores back under leases that qualify and are accounted for as operating leases. We do not have any retained or contingent interests in the stores nor do we provide any guarantees, other than a corporate level guarantee of the lease payments, in connection with sale-leaseback transactions. In accordance with generally accepted accounting principles, our operating leases are not reflected in our consolidated balance sheet.

In connection with certain business dispositions completed between 1991 and 1997, we continue to guarantee lease obligations for approximately 525 former stores. The respective purchasers are required to indemnify the Company for these obligations. If any of the purchasers were to become insolvent, we could be required to assume the lease obligation. However, management believes that any such liability would be unlikely to have a material effect on its financial position or results of operations. We refer you to the Notes to Consolidated Financial Statements on page 42 of our Annual Report to Stockholders included as Exhibit 13 to our Annual Report on Form 10-K for the fiscal year ended January 1, 2005 for a detailed discussion of these guarantees.

Critical Accounting Policies

We prepare our consolidated financial statements in conformity with generally accepted accounting principles, which requires management to make certain estimates and apply judgment. We base our estimates and judgments on historical experience, current trends and other factors that management believes to be important at the time the consolidated financial statements are prepared. On a regular basis, management reviews our accounting policies and how they are applied and disclosed in our consolidated financial statements. While management believes that the historical experience, current trends and other factors considered support the preparation of our consolidated financial statements in conformity with generally accepted accounting principles, actual results could differ from our estimates, and such differences could be material. We refer you to the Notes to Consolidated Financial Statements on pages 32 through 35 of our Annual Report to Stockholders included as Exhibit 13 to our Annual Report on Form 10-K for the fiscal year ended January 1, 2005 for a discussion of our significant accounting policies. Management believes that the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. The critical accounting policies discussed below are applicable to both of our business segments. Management has discussed the development and selection of our critical accounting policies with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the Company's disclosures relating to them.

Impairment of Long-Lived Assets

We evaluate the recoverability of long-lived assets, including intangible assets with finite lives, but excluding goodwill, which is tested for impairment using a separate test, annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We group and evaluate long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. When evaluating long-lived assets for potential impairment, we first compare the carrying amount of the

Edgar Filing: CVS CORP - Form 10-Q

asset to the individual store's estimated future cash flows (undiscounted and without interest charges). If the estimated future cash flows are less than the carrying amount of the asset, an impairment loss calculation is prepared. The impairment loss calculation compares the carrying amount of the asset to the individual store's estimated future cash flows (discounted and with interest charges). If required, an impairment loss is recorded for the portion of the asset's carrying value that exceeds the asset's estimated future cash flow (discounted and with interest charges).

Table of Contents**Part I****Item 2**

Management's Discussion and Analysis of Financial Condition and Results of Operations

Our impairment loss calculation contains uncertainty since we must use judgment to estimate each store's future sales, profitability and cash flows. When preparing these estimates, we consider each store's historical results and current operating trends and our consolidated sales, profitability and cash flow results and forecasts. These estimates can be affected by a number of factors including, but not limited to, general economic conditions, the cost of real estate, the continued efforts of third party organizations to reduce their prescription drug costs, the continued efforts of competitors to gain market share and consumer spending patterns. We have not made any material changes to our impairment loss assessment methodology during the past three years.

Closed Store Lease Liability

We account for closed store lease termination costs in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. As such, when a leased store is closed, we record a liability for the estimated present value of the remaining obligation under the non-cancelable lease, which includes future real estate taxes, common area maintenance and other charges, if applicable. The liability is reduced by estimated future sublease income.

The calculation of our closed store lease liability contains uncertainty since we must use judgment to estimate the timing and duration of future vacancy periods, the amount and timing of future lump sum settlement payments and the amount and timing of potential future sublease income. When estimating these potential termination costs and their related timing, we consider a number of factors, which include, but are not limited to, our historical settlement experience, the owner of the property, the location and condition of the property, the terms of the underlying lease, the specific marketplace demand and general economic conditions. We have not made any material changes in the reserve methodology used to record closed store lease reserves during the past three years.

Self-Insurance Liabilities

We are self insured for certain losses related to general liability, worker's compensation and auto liability, although we maintain stop loss coverage with third party insurers to limit our total liability exposure. The estimate of our self-insurance liability contains uncertainty since we must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. When estimating our self-insurance liability, we consider a number of factors, which include, but are not limited to, historical claim experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. On a quarterly basis, we review our assumptions with our independent third party actuaries to determine that our self-insurance liability is adequate. We have not made any material changes in the accounting methodology used to establish our self-insurance liability during the past three years.

Inventory

Edgar Filing: CVS CORP - Form 10-Q

Our inventory is stated at the lower of cost or market on a first-in, first-out basis using the retail method of accounting to determine cost of sales and inventory in our stores, and the cost method of accounting to determine inventory in our distribution centers. Under the retail method, inventory is stated at cost, which is determined by applying a cost-to-retail ratio to the ending retail value of our inventory. Since the retail value of our inventory is adjusted on a regular basis to reflect current market conditions, our carrying value should approximate the lower of cost or market. In addition, we reduce the value of our ending inventory for estimated inventory losses that have occurred during the interim period between physical inventory counts. Physical inventory counts are taken on a regular basis in each location to ensure that the amounts reflected in the consolidated financial statements are properly stated.

The accounting for inventory contains uncertainty since we must use judgment to estimate the inventory losses that have occurred during the interim period between physical inventory counts. When estimating these losses, we consider a number of factors, which include but are not limited to, historical physical inventory results on a location-by-location basis and current inventory loss trends. We have not made any material changes in the accounting methodology used to establish our inventory loss reserves during the past three years.

Table of Contents

Part I

Item 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

Although we believe that the estimates discussed above are reasonable and the related calculations conform to generally accepted accounting principles, actual results could differ from our estimates, and such differences could be material.

Cautionary Statement Concerning Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a safe harbor for forward-looking statements made by or on behalf of CVS Corporation. The Company and its representatives may, from time to time, make written or verbal forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to stockholders. Generally, the inclusion of the words "believe," "expect," "intend," "estimate," "project," "anticipate," "will," "should" and similar expressions identify statements that constitute forward-looking statements. All statements addressing operating performance of CVS Corporation or any subsidiary, events, or developments that the Company expects or anticipates will occur in the future, including statements relating to sales growth, earnings or earnings per common share growth, free cash flow, debt ratings, inventory levels, inventory turn and loss rates, store development, relocations and new market entries, as well as statements expressing optimism or pessimism about future operating results or events, are forward-looking statements within the meaning of the Reform Act.

The forward-looking statements are and will be based upon management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements. The Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. By their nature, all forward-looking statements involve risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements for a number of reasons, including but not limited to:

The continued efforts of health maintenance organizations, managed care organizations, pharmacy benefit management companies, governmental entities and other third party payers to reduce prescription drug costs and pharmacy reimbursement rates;

The growth of mail order pharmacies and changes to pharmacy benefit plans requiring maintenance and other medications to be filled exclusively through mail order pharmacies;

Our ability to successfully integrate and significantly improve the operating results of the Acquired Businesses in accordance with plan;

Increased competition from other drugstore chains, supermarkets, membership clubs, discount retailers and Internet companies as well as changes in consumer preferences or loyalties;

The frequency and rate of introduction of successful new prescription drugs;

Our ability to generate sufficient cash flows to support capital expansion and general operating activities;

Edgar Filing: CVS CORP - Form 10-Q

Interest rate fluctuations and changes in capital market conditions or other events affecting our ability to obtain necessary financing on favorable terms;

Our ability to identify, implement and successfully manage and finance strategic expansion opportunities including entering new markets, acquisitions and joint ventures;

Our ability to establish effective advertising, marketing and promotional programs (including pricing strategies and price reduction programs implemented in response to competitive pressures and/or to drive demand);

Our ability to continue to secure suitable new store locations under acceptable lease terms;

Our ability to attract, hire and retain suitable pharmacists and management personnel;

Our ability to achieve cost efficiencies and other benefits from various operational initiatives and technological enhancements;

Litigation risks as well as changes in laws and regulations, including changes in accounting standards and taxation requirements (including tax rate changes, new tax laws and revised tax law interpretations);

Table of Contents

Part I

Item 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

The creditworthiness of the purchasers of businesses formerly owned by CVS and whose leases are guaranteed by CVS;

Fluctuations in inventory cost, availability and loss levels and our ability to maintain relationships with suppliers on favorable terms;

Our ability to implement successfully and to manage new computer systems and technologies;

The strength of the economy in general or in the markets served by CVS and changes in consumer purchasing power and/or spending patterns; and

Other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.

The foregoing list is not exhaustive. There can be no assurance that the Company has correctly identified and appropriately assessed all factors affecting its business. Additional risks and uncertainties not presently known to the Company or that it currently believes to be immaterial also may adversely impact the Company. Should any risks and uncertainties develop into actual events, these developments could have material adverse effects on the Company's business, financial condition, and results of operations. For these reasons, you are cautioned not to place undue reliance on the Company's forward-looking statements.

Table of Contents

Part I

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of July 2, 2005, the Company had no derivative financial instruments or derivative commodity instruments in place and believes that its exposure to market risk associated with other financial instruments, principally interest rate risk inherent in its debt portfolio, is not material.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures: The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 (e) and 15d-15(e)) as of July 2, 2005, have concluded that as of such date the Company's disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to the Company and its subsidiaries would be made known to such officers on a timely basis.

Changes in internal control over financial reporting: There have been no changes in our internal controls over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that occurred during the second quarter ended July 2, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

Part II

Item 1

Legal Proceedings

Beginning in August 2001, a total of nine actions were filed against the Company in the United States District Court for the District of Massachusetts asserting claims under the federal securities laws. The actions were subsequently consolidated under the caption In re CVS Corporation Securities Litigation, No. 01-CV-11464 (JLT) (D. Mass.) (the Securities Action). On April 8, 2002, a consolidated and amended complaint was filed. The consolidated amended complaint names as defendants the Company, its chief executive officer and its chief financial officer, and asserts claims for alleged securities fraud under sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder on behalf of a class of persons who purchased shares of the Company's common stock between February 6, 2001 and October 30, 2001.

On October 29, 2004, a class action lawsuit asserting claims under the Employee Retirement Income Security Act was filed under the caption Fescina v. CVS Corp., et. al., No. 04-CV-12309 (JLT) (D. Mass.) (the ERISA Action). The purported class includes persons who were participants in or beneficiaries of the CVS 401(k) plan between December 1, 2000 and October 30, 2001. The suit was filed in the United States District Court for the District of Massachusetts and designated as related to the Securities Action. The complaint names as defendants the Company, its chief executive officer, members of its Board of Directors, and certain unnamed fiduciaries.

On December 17, 2004, Richard Krantz filed a shareholder derivative suit under the caption Krantz v. Ryan, et. al., No. 04-CV-12650 (REK) (D. Mass) (the Derivative Action), based upon essentially the same allegations that underlie the Securities Action and the ERISA Action. The suit was filed in the United States District Court for the District of Massachusetts and subsequently consolidated with the Securities Action. The complaint names as defendants the Company (as nominal defendant), its chief executive officer, its chief financial officer, and members of its Board of Directors.

Although the Company believes the Securities, ERISA and Derivative Actions are without merit, it has entered into settlement agreements, which have been preliminarily approved by the court, to avoid the risk and diversion of resources associated with trial. The settlements, which are subject to final approval by the court, are being paid for primarily by the Company's insurers.

As previously disclosed, the Rhode Island Attorney General's office, the Rhode Island Ethics Commission, and the United States Attorney's Office for the District of Rhode Island have been investigating the business relationships between certain former members of the Rhode Island General Assembly and various Rhode Island companies, including CVS. The Company has learned that, in connection with the investigation of these business relationships, a former state senator has been criminally charged by state and federal authorities. The Company has also learned that this former state senator intends to plead guilty to the federal charges. CVS will continue to cooperate fully with these investigations.

Table of Contents**Part II****Item 4****Submission of Matters to a Vote of Security Holders**

The following matters were submitted to a vote of security holders at our Annual Meeting of Stockholders, which was held on Thursday, May 12, 2005 in Woonsocket, Rhode Island:

	<i>Broker</i>			
	<i>For</i>	<i>Withheld</i>	<i>Abstained</i>	<i>Non-Votes</i>
1. The election, for one-year terms, of all persons nominated for directors, as set forth in the Company's proxy statement dated March 25, 2005, was approved by the following votes:				
W. Don Cornwell				
Thomas P. Gerrity				
Stanley P. Goldstein				
Marian L. Heard				
William H. Joyce	330,100,484	10,009,986		
Terrence Murray	332,242,827	7,867,643		
Sheli Z. Rosenberg	331,384,188	8,726,282		
Thomas M. Ryan	327,458,601	12,651,869		
Alfred J. Verrecchia	263,643,617	76,466,853		
	330,858,820	9,251,650		
	330,346,611	9,763,859		
	330,318,809	9,791,661		
	325,722,253	14,388,217		
2. Ratification of the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2005, was approved by the following vote:				
	332,109,582	5,780,313	2,220,575	
3. Stockholder proposal regarding election of directors by majority rather than plurality vote, as set forth in the Company's proxy statement dated March 25, 2005, was rejected by the following vote:				
	110,699,383	191,059,738	3,278,586	35,072,763
4. Stockholder proposal regarding performance and time-based restricted shares, as set forth in the Company's proxy statement dated March 25, 2005, was rejected by the following vote:				
	26,450,159	274,895,218	3,692,330	35,072,763
5. Stockholder proposal regarding non-deductible executive compensation, as set forth in the Company's proxy statement dated March 25, 2005, was rejected by the following vote:				
	18,160,569	283,295,698	3,581,440	35,072,763

Table of Contents

Part II

Item 5

Other Information

As a retention initiative for Thomas M. Ryan, Chairman of the Board, President and Chief Executive Officer, the Management Planning and Development Committee of the CVS Board of Directors, on August 5, 2005, (i) agreed that subject to Mr. Ryan's remaining employed through the end of 2009, CVS would waive the 30-year cap in the Company's Supplemental Executive Retirement Plan on credited service for Mr. Ryan and provide Mr. Ryan upon his retirement with financial planning services, office space and the services of an assistant for five years at the Company's expense; and (ii) made a grant of 400,000 restricted stock units to Mr. Ryan which will vest on December 31, 2009, and which provides for settlement after Mr. Ryan's retirement from the Company.

Table of Contents

Part II

Item 6

Exhibits

Exhibits:

- 3.1 Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to CVS Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 1996).
- 3.1A Certificate of Amendment to the Amended and Restated Certificate of Incorporation, effective May 13, 1998 (incorporated by reference to Exhibit 4.1A to Registrant's Registration Statement No. 333-52055 on Form S-3/A dated May 18, 1998).
- 3.2 By-laws of the Registrant, as amended and restated (incorporated by reference to Exhibit 3.2 to CVS Corporation's Current Report on Form 8-K dated June 1, 2005).
- 10.1 Five Year Credit Agreement dated as of June 3, 2005 by and among the Registrant, the lenders party hereto, Bank of America, N.A., Credit Suisse First Boston, Wachovia Securities, Inc., and National Association as Co-Syndication Agents, Suntrust Bank as Documentation Agent, and The Bank of New York, as Administrative Agent.
- 15.1 Letter re: Unaudited Interim Financial Information.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Signatures:

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

CVS Corporation
(Registrant)

/s/ David B. Rickard

David B. Rickard
Executive Vice President,
Chief Financial Officer and
Chief Administrative Officer
August 9, 2005